

April 5, 2006

Ms. Mary Rupp
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Supervisory Committee Audits

Dear Ms. Rupp:

Navy Federal Credit Union provides the following comments in response to the National Credit Union Administration's (NCUA) advance notice of proposed rulemaking on the Supervisory Committee audit rules.

Navy Federal remains strongly committed to accurate and transparent financial statement and regulatory reporting. We believe the existing regulations in part 715 are reasonably designed to provide accurate and transparent credit union reporting and are appropriate given the limited nature and complexity of credit unions relative to other types of financial institutions.

The past and present financial strength and stability of the credit union industry is a testament to the effectiveness of existing part 715 and credit union Supervisory Committees. To date, the National Credit Union Share Insurance Fund (NCUSIF) has proven to be financially sound. Such an outstanding track record is due in large part to NCUA's skill in prudently fortifying the NCUSIF, its close attention to credit union examination reports, and its appropriate monitoring of identified or potential credit union financial or other weaknesses. It is also due in part to credit unions' commitment to the requirements in part 715 and the diligent oversight of credit union Supervisory Committees. We encourage NCUA to consider the record of effectiveness of existing part 715 when determining whether additional regulatory burden is necessary.

If NCUA determines that additional audit requirements are needed, we urge the Agency to consider the unique nature of credit unions when developing these requirements. Credit unions are limited in nature and complexity relative to other types of financial institutions; therefore, we do not believe that simply including the FDIC's attestation requirements in NCUA's rules would be appropriate without careful consideration of whether such regulation is appropriate or is the minimum necessary to achieve the desired results.

We provide additional comments in response to the questions enumerated in NCUA's advance notice of proposed rulemaking as follows:

Q1. Should part 715 require, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting above a certain minimum asset size threshold? Explain why or why not.

Navy Federal does not believe that an attestation on internal controls is necessary or appropriate for credit unions. We believe that the current requirements in part 715 provide adequate assurances on the accuracy of financial statement reporting. Further, most large credit unions employ internal auditors who regularly review and test controls over financial reporting. In addition, NCUA has proven its ability to closely examine its regulated credit unions and adjust the NCUSIF appropriately. Such an excellent track record of well-managed credit unions and a well-managed NCUSIF does not warrant additional regulatory burden.

If credit unions were required to obtain an attestation on internal controls, the costs associated with the documentation of internal controls and the external auditor attestation would be high. It is likely that many credit unions would be forced to divert some of their valuable internal audit resources to the task of documenting existing controls. Further, it is our understanding that the external auditor expenses for many Securities and Exchange Commission (SEC)-regulated entities doubled when an attestation requirement was implemented for them. We believe that credit unions would face similar cost increases from their external auditors. The burden of these additional costs would likely outweigh any benefits NCUA or credit unions may receive from such attestations.

Q2. What minimum asset size threshold would be appropriate for requiring, in addition to a financial statement audit, an “attestation on internal controls” over financial reporting, given the additional burden on management and its external auditor? Explain the reasons for the threshold you favor.

Again, Navy Federal opposes extending this requirement to credit unions. However, if NCUA requires the attestation, we believe that the minimum asset size threshold should not be lower than \$1 billion. It is our understanding that the threshold for banks and thrifts is \$1 billion, and we are unaware of any reasons why the threshold for credit unions should be more burdensome.

Q3. Should the minimum asset size threshold for requiring an “attestation on internal controls” over financial reporting be the same for natural person credit unions and corporate credit unions? Explain why.

If NCUA requires the attestation, we believe the minimum asset size threshold should be the same for both natural person and corporate credit unions. We are not aware of any reason why the thresholds should be different; therefore, we support consistency between the thresholds.

Q4. Should management’s assessments of the effectiveness of internal controls and the attestation by its external auditor cover all financial reporting, (i.e., financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes), or should it be more narrowly framed to cover only certain types of financial reporting? If so, which types?

We believe that management's assessments of the effectiveness of internal controls and the attestation by the external auditor should cover financial statements prepared in accordance with GAAP and those prepared for regulatory reporting purposes. Both types of reports include similar financial data, and applying the assessment and attestation to them both will promote consistency.

Q5. Should the same auditor be permitted to perform both the financial statement audit and the "attestation on internal controls" over financial reporting, or should a credit union be allowed to engage one auditor to perform the financial statement audit and another to perform the "attestation on internal controls"? Explain the reasons for your answer.

We believe that credit unions should be allowed to decide whether to engage one or more auditors to perform both the financial statement audit and the attestation on internal controls over financial reporting. We do not believe that allowing a single auditor to perform both the financial statement audit and the attestation would diminish the validity of either task. Further, allowing a credit union to engage a single auditor for both tasks would reduce costs associated with the attestation.

Q6. If an "attestation on internal controls" were required of credit unions, should it be required annually or less frequently? Why?

If an attestation on internal controls were required of credit unions, we would support an annual frequency. Such a frequency would allow credit unions to engage their external auditors to perform the attestations at the same time as the external auditors perform the annual financial statement audits, making the attestations as efficient as possible. Further, such a frequency will be less costly and less disruptive to credit union operations because external auditors generally test some of the financial reporting internal controls while completing the financial statement audits.

Q7. If an "attestation on internal controls" were required of credit unions, when should the requirement become effective (i.e., in the fiscal period beginning after December 15 of what year)?

If attestations on internal controls were required of credit unions, we believe credit unions should have at least 24 months from the date any final rule change is published until the beginning of the fiscal period for which the attestation is required to comply. We believe such a time period would be consistent with the time period that SEC-regulated entities were afforded to comply with the attestation requirements under the *Sarbanes-Oxley Act*, and we believe it would give credit unions sufficient time to prepare for the implementation of the new requirements.

Q8. If credit unions were required to obtain an "attestation on internal controls," should part 715 require that those attestations, whether for a natural person or corporate credit union, adhere to the PCAOB's AS 2 standard that applies to public companies, or to the AICPA's revised AT 501 standard that applies to non-public companies? Please explain your preference.

If credit unions were required to obtain an attestation on internal controls, we believe that they should be required to comply with the AICPA's standard because credit unions more closely resemble non-public companies.

Q9. Should NCUA mandate COSO's Internal Control—Integrated Framework as the standard all credit union management must follow when establishing, maintaining and assessing the effectiveness of the internal control structure and procedures, or should each credit union have the option to choose its own standard?

We believe the COSO standard was designed mainly for use by public companies. Such a standard would impose an unnecessary burden on non-public companies, like credit unions. Instead, we encourage NCUA to develop its own standard, appropriate for credit unions, for management to follow when establishing, maintaining and assessing the effectiveness of the internal control structure. Further, we strongly urge the Agency to release a draft of this standard for at least a 90-day public comment period.

Q10. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have a minimum level of experience or expertise in credit union, banking or other financial matters? If so, what criteria should they be required to meet and what should the minimum asset size threshold be?

All Supervisory Committee members for credit unions with \$1 billion or more in assets should be required to have some level of experience or expertise in credit union, banking, or other financial matters. However, we believe that credit union Boards of Directors should be allowed to determine the appropriate level of experience or expertise required.

Q11. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be required to have access to their own outside counsel? If so, at what minimum asset size threshold?

No, we do not believe that Supervisory Committee members of credit unions should be required to have access to their own outside counsel. Instead, we believe that it is important for Supervisory Committee members to simply have the option of obtaining access to outside counsel if they so choose, regardless of the credit union's asset size.

Q12. Should Supervisory Committee members of credit unions above a certain minimum asset size threshold be prohibited from being associated with any large customer of the credit union other than its sponsor? If so, at what minimum asset size threshold?

We are unsure how NCUA is using the term "large customer" in this advance notice of proposed rulemaking. We assume NCUA is using it in a way similar to the way it is used in the FDIC's regulations at 12 CFR 363 Appendix A, Guideline 33:

“Any individual or entity (including a controlling person of any such entity) which, in the determination of the board of directors, has such significant direct or indirect credit or other relationships with the institution, the termination of which likely would materially and adversely affect the institution’s financial condition or results of operations...”

Navy Federal does not believe that such “large customers” exist in most credit unions. Regardless, we do not believe that any credit union Supervisory Committee members should have conflicts of interest with credit union operations, including member and third-party vendor relationships.

Q13. If any of the qualifications addressed in questions 10, 11 and 12 above were required of Supervisory Committee members, would credit unions have difficulty in recruiting and retaining competent individuals to serve in sufficient numbers? If so, describe the obstacles associated with each qualification.

We believe the requirements in Questions 10 and 11 could have a negative impact on credit unions, particularly credit unions with less than \$1 billion in assets, in recruiting and retaining competent individuals to serve on their Supervisory Committees. We do not believe the requirements in Question 12 would negatively impact credit union Committee member recruitment and retention.

Q14. Should a State-licensed, compensated auditor who performs a financial statement audit and/or “internal control attestation” be required to meet just the AICPA’s “independence” standards, or should they be required to also meet SEC’s “independence” requirements and interpretations? If not both, why not?

We believe that state-licensed, compensated auditors performing financial statement audits or internal control attestations should only be required to meet the AICPA’s independence standards. As we understand it, the SEC’s independence standards apply to public companies; therefore, we do not believe that they are appropriate or necessary to require for credit union auditors.

Q15. Is there value in retaining the “balance sheet audit” in existing § 715.7(a) as an audit option for credit unions with less than \$500 million in assets?

Referring back to our response to Question 2, we believe the threshold should be increased to \$1 billion. Therefore, we believe credit unions with less than \$1 billion in assets should be permitted to perform “balance sheet audits,” given their limited size and complexity. Additional audit requirements for these credit unions would simply impose unwarranted cost burdens.

Q16. Is there value in retaining the “Supervisory Committee Guide audit” in existing § 715.7(c) as an audit option for credit unions with less than \$500 million in assets?

Yes, we believe NCUA should retain the "Supervisory Committee Guide Audit" in existing part 715 as an option for credit unions with less than \$500 million in assets. We believe this is a viable, appropriate option for those credit unions.

Q17. Should part 715 require credit unions that obtain a financial statement audit and/or an "attestation on internal controls" (whether as required or voluntarily) to forward a copy of the auditor's report to NCUA? If so, how soon after the audit period-end? If not, why not?

We believe that NCUA should simply review the financial statement audit and attestation, if required, in conjunction with the credit union's regularly-scheduled examination. We believe such a process would be efficient for both the credit union and the NCUA examiners.

Q18. Should part 715 require credit unions to provide NCUA with a copy of any management letter, qualification, or other report issued by its external auditor in connection with services provided to the credit union? If so, how soon after the credit union receives it? If not, why not?

We believe that NCUA should review management letters, qualifications, and other reports issued by the credit union's external auditor in conjunction with the credit union's regularly-scheduled examination. Again, we believe such a process would be efficient for both the credit union and the NCUA examiners.

Q19. If credit unions were required to forward external auditors' reports to NCUA, should part 715 require the auditor to review those reports with the Supervisory Committee before forwarding them to NCUA?

We believe that Supervisory Committees should be informed of all audit reports prior to NCUA's reviews and that such a practice is the mark of a prudent and well-managed credit union. We do not believe, however, that the auditor should be explicitly required by regulation to review those reports with the Supervisory Committee before forwarding them to NCUA. Such a requirement is unnecessary to add to the regulation.

Q20. Existing part 715 requires a credit union's engagement letter to prescribe a target date of 120 days after the audit period-end for delivery of the audit report. Should this period be extended or shortened? What sanctions should be imposed against a credit union that fails to include the target delivery date within its engagement letter?

We believe the target of 120 days in existing part 715 is sufficient in most cases. However, external auditors are usually hesitant to commit to delivering their opinions by certain dates. Sometimes unforeseeable conditions arise during the audit that require additional testing, which may make it difficult for the auditors to meet the initial target delivery dates. Therefore, we believe that credit unions and external auditors should have some flexibility in meeting the target dates if justifiable extenuating circumstances arise.

Ms. Mary Rupp
Page 7
April 5, 2006

Q21. Should part 715 require credit unions to notify NCUA in writing when they enter into an engagement with an auditor, and/or when an engagement ceases by reason of the auditor's dismissal or resignation? If so in cases of dismissal or resignation, should the credit union be required to include reasons for the dismissal or resignation?

We believe that it would be most efficient for NCUA to simply review any documents related to the dismissal or resignation of an auditor during the credit union's regularly-scheduled examination.

Q22. NCUA recently joined in the final Interagency Advisory on the Unsafe and Unsound Use of Limitation of Liability Provisions in External Audit Engagement Letters, 71 FR 6847 (Feb. 9, 2006). Should credit union Supervisory Committees be prohibited by regulation from executing engagement letters that contain language limiting various forms of auditor liability to the credit union? Should Supervisory Committees be prohibited from waiving the auditor's punitive damages liability?

We support prohibiting by regulation Supervisory Committees from executing engagement letters that contain the limitations of auditor liability outlined in the final *Interagency Advisory*. However, we believe Supervisory Committees should have the option of waiving auditors' punitive damages liability. For credit unions that waive auditors' punitive damages liability, we would support requiring those credit unions to annually disclose the nature of such arrangements in their financial reports.

Navy Federal appreciates the opportunity to provide comments in response to NCUA's advance notice of proposed rulemaking on the Supervisory Committee audit rules.

Sincerely,

A handwritten signature in black ink, appearing to read "W. A. Earner", with a stylized flourish at the end.

W. A. Earner
Acting President/CEO

WAE/sb